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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79116; File No. SR-FINRA-2016-027)

October 18, 2016

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Reporting of Transactions in U.S. Treasury Securities to TRACE

I. Introduction

On July 18, 2016, the Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to require FINRA members to report secondary market transactions in U.S. Treasury securities to the Trade Reporting and Compliance Engine ("TRACE"). The proposed rule change was published for comment in the Federal Register on July 25, 2016.[3] The Commission received 12 comments in response to the proposed rule change.[4] On September 6, 2016, FINRA consented

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 78359 (July 19, 2016), 81 FR 48465 ("Notice").

4 See letters to Brent J. Fields, Secretary, Commission, from Mike Nicholas, Chief Executive Office, Bond Dealers of America ("BDA"), dated August 15, 2016 ("BDA Letter"); Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel LLC ("Citadel"), dated August 15, 2016 ("Citadel Letter"); Shane O'Cuinn, Managing Director, Credit Suisse, dated August 15, 2016 ("Credit Suisse Letter"); Marc R. Bryant, Senior Vice President and Deputy General Counsel, Fidelity Investments ("Fidelity"), dated August 15, 2016 ("Fidelity Letter"); David W. Blass, General Counsel, Investment Company Institute ("ICI"), dated August 15, 2016 ("ICI Letter"); John A. McCarthy, General Counsel, KCG Holdings, Inc. ("KCG"), dated August 15, 2016 ("KCG Letter"); Robert Toomey, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association ("SIFMA") and Timothy W. Cameron, Head, Asset Management Group, Head, Asset Management Group, SIFMA, dated August 15, 2016

to an extension of time for the Commission to act on the proposal until October 21, 2016.[5] FINRA responded to the comments and filed Amendment No. 1 to the proposal on September 23, 2016.[6] The Commission is publishing this notice to solicit comment on Amendment No. 1 to the proposal from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Background

As described in further detail below, FINRA has proposed to require its members to report transactions in U.S. Treasury securities to TRACE. At this time, FINRA is not proposing to publicly disseminate any reports of transactions in U.S. Treasury securities, nor is FINRA proposing at this time to impose any fees on its members for the reporting of such transactions.

A. Origin of the Proposal

On the morning of October 15, 2014, the market for U.S. Treasury securities, futures, and other closely related instruments experienced an unusually high level of volatility. Subsequently,

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("SIFMA Letter"); and Douglas Friedman, General Counsel, Tradeweb Markets LLC ("Tradeweb"), dated August 15, 2016 ("Tradeweb Letter"); and letters to Robert W. Errett, Deputy Secretary, Commission, from Mary Lou Von Kaenel, Managing Director, Financial Information Forum ("FIF"), dated August 15, 2016 ("FIF Letter"); Manisha Kimmel, Chief Regulatory Officer, Wealth Management, Thomson Reuters, dated August 15, 2016 ("Thomson Reuters Letter"); and John Shay, Senior Vice President, Virtu Financial, Inc. ("Virtu"), dated August 15, 2016 ("Virtu Letter"); and letter from Jane Carson, received on August 5, 2016 ("Carson Letter").

5 See letter from Brant K. Brown, Associate General Counsel, FINRA, to Katherine England, Assistant Director, Division of Trading and Markets, Commission, dated September 6, 2016.

6 See letter from Brant Brown, Associate General Counsel, FINRA, to Brent J. Fields, Secretary, Commission, dated September 23, 2016 ("FINRA Response"). Amendment No. 1 revised the proposal to indicate that the ".S" modifier must be used if a transaction is part of a series of transactions and may not be priced based on the current market. FINRA posted a copy of its Amendment No. 1 on its website when if filed the amendment with the Commission. Amendment No. 1 is also available at https://www.sec.gov/comments/sr-finra-2016-027/finra2016027-14.pdf.

an interagency working group consisting of representatives from the Commission, the Department of the Treasury (the "Treasury Department"), the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, and the Commodity Futures Trading Commission ("CFTC") issued a report ("Joint Staff Report") analyzing the structure of the U.S. Treasury market and the conditions that contributed to the market volatility on October 15.[7] The Joint Staff Report proposed several next steps in understanding the U.S. Treasury market, including an assessment of the data about the U.S. Treasury market available to the public and to the official sector.[8]

Following the publication of the Joint Staff Report, the Treasury Department published a Request for Information ("RFI") seeking public comment on structural changes in the U.S. Treasury market and their implications for the overall functioning of this market, including considerations with respect to more comprehensive official sector access to Treasury securities market data.[9] The RFI Notice observed that "[t]he official sector does not currently receive any regular reporting of Treasury cash market transactions" and that "[t]he need for more comprehensive official sector access to data, particularly with respect to U.S. Treasury cash market activity, is clear."[10]

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7 See Treasury Department et al., Joint Staff Report: The U.S. Treasury Market on October 15, 2014 (July 13, 2015), https://www.sec.gov/reportspubs/special-studies/treasury-market-volatility-10-14-2014-joint-report.pdf.

8 See Joint Staff Report at 6-7.

9 See Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 FR 3928, 3931 (January 22, 2016) ("RFI Notice").

10 Id. at 3931.

The Treasury Department received 52 comment letters in response to the RFI Notice.[11] Following a review of these comments, the Treasury Department and the Commission announced that, as part of their efforts to obtain better information about the U.S. Treasury market for oversight purposes, the agencies had requested FINRA to consider a proposal to require its members to report transactions in U.S. Treasury securities to a centralized repository.[12]

B. Definitions and Scope of Proposal

The TRACE reporting rules apply to "Reportable TRACE Transactions," as defined in FINRA Rule 6710(c), involving "TRACE-Eligible Securities," as defined in FINRA Rule 6710(a). Because the current definition of "TRACE-Eligible Security" specifically excludes a "U.S. Treasury Security," FINRA members currently are not required to report any transactions in U.S. Treasury Securities to TRACE. The proposal would amend the definition of "TRACE-Eligible Security" to include a U.S. Treasury Security, which would have the effect of rendering a transaction in a U.S. Treasury Security a Reportable TRACE Transaction.

The proposal would revise the existing definition of "U.S. Treasury Security" in FINRA Rule 6710(p) to include separate principal and interest components of a U.S. Treasury Security that have been separated pursuant to the Separate Trading of Registered Interest and Principal of

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11 See https://www.regulations.gov/document?D=TREAS-DO-2015-0013-0001.

12 See Press Release, Treasury Department, Statement on Trade Reporting in the U.S. Treasury Market (May 16, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0457.aspx ("Treasury Press Release"). See also Joint Press Release, Treasury Department and Commission, Statement on Trade Reporting in the U.S. Treasury Market (May 16, 2016), https://www.sec.gov/news/pressrelease/2016-90.html ("May 16 Joint Press Release").

Securities (STRIPS) program operated by the Treasury Department.[13] The proposal also would revise several defined terms to ensure that the definition of "TRACE-Eligible Security" encompasses Treasury bills, which have maturities of one year or less. The existing definition of "TRACE-Eligible Security" in FINRA Rule 6710(a) excludes a Money Market Instrument. FINRA Rule 6710(o) currently defines "Money Market Instrument" to include, among other things, a debt security that at issuance has a maturity of one calendar year or less. A Treasury bill with a maturity of one year or less would fall within the current definition of "Money Market Instrument" and, accordingly, would not be a TRACE-Eligible Security. To provide for the reporting of transactions in U.S. Treasury bills, the proposal would revise the current definition of "Money Market Instrument" to exclude U.S. Treasury Securities. Thus, the definition of "TRACE-Eligible Security" would include Treasury bills, as well as Treasury bonds, notes, and the separate principal and interest components of a U.S. Treasury Security that have been separated pursuant to the STRIPS program.

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[13] Although trading a principal or interest component of a U.S. Treasury Security that has been separated under the STRIPS program would constitute a Reportable TRACE Transaction, the act of separating or reconstituting the components of a U.S. Treasury Security under the STRIPS program would not constitute a Reportable TRACE Transaction. This is because, for purposes of the trade reporting rules, FINRA considers a "trade" or a "transaction" to entail a change of beneficial ownership between parties. See, e.g., Securities Exchange Act Release No. 74482 (March 11, 2015), 80 FR 13940, 13941 (March 17, 2015) (order approving File No. SR-FINRA-2014-050) (noting that, in the context of TRACE reporting, "[b]ecause the transaction between the member and its non-member affiliate represents a change in beneficial ownership between different legal entities, it is a reportable transaction and is publicly disseminated under the current rule"); Trade Reporting Frequently Asked Questions, Q100.4, http://www.finra.org/industry/trade-reporting-faq#100 (defining "trade" and "transaction" for purposes of the equity trade reporting rules as a change in beneficial ownership). See Notice, 81 FR at 48467. FINRA has proposed new Supplementary Material .05 to FINRA Rule 6730 to address the reporting obligation associated with this process.

In addition, the proposal would revise the definition of "U.S. Treasury Security" to exclude savings bonds. FINRA notes that savings bonds issued by the Treasury Department are generally non-transferable and are therefore not marketable securities purchased and sold in the secondary market. Therefore, FINRA did not believe that it was appropriate to include savings bonds within the scope of this proposal.[14]

Under the proposal, any transaction in a U.S. Treasury Security is a "Reportable TRACE Transaction" and would therefore be subject to TRACE reporting requirements, unless it fell within an enumerated exception.[15] FINRA notes that all U.S. Treasury Securities that, under the proposal, would be reportable to TRACE are offered to the public by the Treasury Department through an auction process.[16] When-issued trading in U.S. Treasury Securities can begin before the auction takes place after the Treasury Department announces an auction.[17] When-issued transactions in U.S. Treasury Securities currently are not reported to the Treasury Department.[18] Under the proposal, when-issued transactions would be reportable to TRACE. In connection with this reporting requirement, FINRA has proposed new definitions of "Auction" and "When-Issued Transaction."[19]

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14 See Notice, 81 FR at 48466.

15 See id. at 48467.

16 See id.

17 See id. When-issued trading of Treasury securities, i.e., the trading of forward contracts with a delivery date after the securities are issued, begins on the date of the announcement of a Treasury auction and continues after the auction takes place, up until the issue date. Prior to an auction, when-issued securities are quoted for trading on a yield basis because a coupon is not determined until after the auction is completed. After the auction, the securities are quoted on a price basis.

18 See id.

19 See proposed FINRA Rules 6710(ff) (defining "Auction") and 6710(hh) (defining "When-Issued Transaction").

Existing FINRA Rule 6730(e) enumerates several transactions and transfers of TRACE-Eligible Securities that are not reportable to TRACE. The proposal would add two types of transactions to the list in FINRA Rule 6730(e). First, FINRA Rule 6730(e) would be expanded to include bona fide repurchase and reverse repurchase transactions involving TRACE-Eligible Securities. FINRA notes that, although repurchase and reverse repurchase transactions are structured as purchases and sales, the transfer of securities effectuated as part of these transactions is not made as the result of an investment decision, but is more akin to serving as collateral pledged as part of a secured financing.[20] Consequently, repurchase and reverse repurchase transactions are, according to FINRA, economically equivalent to financings, and the pricing components of these transactions are typically not the market value of the securities.[21] For these reasons, FINRA historically has taken the position that repurchase and reverse repurchase transactions should not be reported to TRACE.[22]

Second, FINRA Rule 6730(e) would be expanded to include Auction Transactions, which proposed FINRA Rule 6710(gg) would define as "the purchase of a U.S. Treasury Security in an Auction." FINRA asserts that the Treasury Department maintains transaction data for Auction Transactions and that this data is readily accessible to regulators.[23] Accordingly, FINRA believes that TRACE reporting of these transactions would be duplicative and of little additional benefit to regulators.[24]

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20 See Notice, 81 FR at 48467.

21 See id.

22 See id. See also Reporting of Corporate and Agencies Debt Frequently Asked Questions, Question 4.6, http://www.finra.org/industry/faq-reporting-corporate-and-agencies-debt-frequently-asked-questions-faq.

23 See Notice, 81 FR at 48467.

24 See id.

C. Reporting Obligations

As is currently the case with all TRACE reporting obligations, any FINRA member that is a "Party to a Transaction" in a TRACE-Eligible Security is required to report the transaction.[25] Thus, by amending the definition of "TRACE-Eligible Security" in the manner described above, FINRA would require members to report transactions in U.S. Treasury Securities to TRACE. If both counterparties are FINRA members, both would have the duty to report.[26]

Under the proposal, a transaction in a U.S. Treasury Security would have to be reported on a same-day or next-day basis, depending on the time of execution.[27] FINRA states that it is proposing this reporting requirement, rather than a more immediate reporting requirement, because FINRA is not currently proposing to publicly disseminate any trade-level information regarding transactions in U.S. Treasury Securities.[28]

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25 See id. See also FINRA Rules 6730(a) and 6730(b)(1).

26 See Notice, 81 FR at 48467.

27 See proposed FINRA Rule 6730(a)(4). See also Notice, 81 FR at 48467. Under proposed FINRA Rule 6730(a)(4), a Reportable TRACE Transaction in a U.S. Treasury Security executed on a business day at or after 12:00:00 a.m. Eastern Time through 5:00:00 p.m. Eastern Time would have to be reported the same day during TRACE System Hours. A transaction executed on a business day after 5:00:00 p.m. Eastern Time but before the TRACE system closes would have to be reported no later than the next business day (T+1) during TRACE System Hours, and, if reported on T+1, would have to be designated "as/of" and include the date of execution. A transaction executed on a business day at or after 6:30:00 p.m. Eastern Time through 11:59:59 p.m. Eastern Time—or on a Saturday, a Sunday, a federal or religious holiday, or other day on which the TRACE system is not open at any time during that day (determined using Eastern Time)—would have to be reported the next business day (T+1) during TRACE System Hours, designated "as/of," and include the date of execution. See also FINRA Rule 6710(t) (defining "TRACE System Hours").

28 See Notice, 81 FR at 48467.

FINRA Rule 6730(c) lists the specific transaction information that a member must report to TRACE for each Reportable TRACE Transaction.[29] These existing requirements generally would apply to Reportable TRACE Transactions in U.S. Treasury Securities but with certain modifications to clarify the reporting of certain information for transactions involving U.S. Treasury Securities.[30] First, the proposal would amend FINRA Rule 6730(c)(3) to indicate that a member must report yield in lieu of price for a When-Issued Transaction because when-issued trading is based on yield rather than on price as a percentage of face or par value.[31]

Second, the proposal would amend FINRA Rule 6730(d)(1) to specify that (1) for a When-Issued Transaction conducted on a principal basis, the reported yield must include the mark-up or mark-down; and (2) for a When Issued Transaction conducted on an agency basis, the reported yield must exclude the commission and the member must report the total dollar amount of any commission separately.[32]

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29 FINRA Rule 6730(c) requires the appropriate member to report the following information for each Reportable TRACE Transaction: (1) the CUSIP number or, if a CUSIP number is not available at the Time of Execution, a similar numeric identifier or a FINRA symbol; (2) the size (volume) of the transaction, as required by Rule 6730(d)(2); (3) the price of the transaction (or the elements necessary to calculate price, which are contract amount and accrued interest) as required by Rule 6730(d)(1); (4) a symbol indicating whether the transaction is a buy or a sell; (5) the date of Trade Execution (for "as/of" trades only); (6) the contra-party's identifier (MPID, customer, or a non-member affiliate, as applicable); (7) capacity — Principal or Agent (with riskless principal reported as principal); (8) the time of execution; (9) reporting side executing broker as "give-up" (if any); (10) contra side Introducing Broker in case of "give-up" trade; (11) the commission (total dollar amount); (12) the date of settlement; (13) if the member is reporting a transaction that occurred on an ATS pursuant to FINRA Rule 6732, the ATS's separate MPID obtained in compliance with FINRA Rule 6720(c); and (14) such trade modifiers as required by either the TRACE rules or the TRACE users' guide.

30 See Notice, 81 FR at 48468.

31 See id.

32 See id.

Third, the proposal would add new Supplementary Material .04 to FINRA Rule 6730 to specify that, when reporting a transaction in a U.S. Treasury Security executed electronically, a member would have to report the time of execution to the finest increment of time captured in the member's system (e.g., millisecond or microsecond), but at a minimum, in increments of seconds.[33] FINRA noted that the proposal would not require members to update their systems to comply with a finer time increment, but to report the time of execution only in the same time increment captured by the member's system.[34] FINRA also noted that a significant portion of the trading in the U.S. Treasury cash market occurs on electronic platforms, many of which capture timestamps in sub-second increments.[35]

Fourth, the proposal would add new FINRA Rule 6730(d)(4)(G) to implement a new trade indicator and two new trade modifiers that are specific to transactions in U.S. Treasury Securities. FINRA states that a new trade indicator for When-Issued Transactions would allow FINRA to readily determine whether a price is being reported based on a percentage of face or par value or whether the member is reporting the yield, as required for When-Issued Transactions.[36] This indicator also would be used to validate a transaction in a U.S. Treasury Security reported with an execution date before the auction for the security has taken place.[37] Because transactions in U.S. Treasury Securities often are executed as part of larger trading

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33 See id.

34 See id. FINRA noted that the rules governing the trade reporting of equity securities require a member to report time to the millisecond if the member captures time to that level of granularity. See id.; FINRA Rule 6380A, Supplementary Material .04; FINRA Rule 6380B, Supplementary Material .04; FINRA Rule 6622, Supplementary Material .04. See also FINRA Regulatory Notice 14-21 at 3 (May 2014).

35 See Notice, 81 FR at 48468.

36 See id.

37 See id.

strategies, the proposal also would add two new modifiers for these transactions.[38] Proposed FINRA Rule 6730(d)(4)(G)(ii)(a) would require a member to add a ".B" modifier to the trade report for a transaction that is part of a series of transactions in which at least one involves a futures contract.[39] Proposed FINRA Rule 6730(d)(4)(G)(ii)(b) would require a member to add a ".S" modifier if a transaction is part of a series of transactions and might not be priced based on the current market.[40] According to FINRA, the ".B" and ".S" modifiers would allow FINRA to better understand and evaluate execution prices of transactions in U.S. Treasury Securities that otherwise might appear aberrant, thus potentially reducing the number of false positives generated through automated surveillance mechanisms that include the price as part of the surveillance pattern.[41]

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38 See id.

39 See id.

40 FINRA Rule 6730(d)(4)(G)(ii)(b), as originally proposed, would have required use of the ".S" modifier "if the transaction is part of a series of transactions where at least one of the transactions is executed at a pre-determined fixed price or would otherwise result in the transaction being executed away from the current market" (emphasis added). One commenter stated that this formulation suggests that only transactions executed away from the market should be assigned the ".S" modifier. See SIFMA Letter at 7. The commenter recommended, instead, that the ".S" modifier apply to any transaction that is part of a series, regardless of whether one or more of the legs of the trade is, in fact, away from the current market. See id. FINRA agreed that the ".S" modifier should be utilized whenever a transaction is part of a series and therefore could be, but need not be, priced away from the market. Therefore, in Amendment No. 1, FINRA revised proposed Rule 6730(d)(4)(G)(ii)(b) to require use of the ".S" modifier if a transaction "is part of a series of transactions and may not be priced based on the current market" (emphasis added). FINRA expressed the view that Amendment No. 1 should reduce compliance burdens because a member would not be required to assess whether a particular transaction was, in fact, priced away from the market at the time of execution when attaching the ".S" modifier. See FINRA Response at 9.

41 See Notice, 81 FR at 48468.

D. Additional Changes

The proposal would amend FINRA Rule 6750(b) to add U.S. Treasury Securities to the list of transaction types for which transaction information will not be disseminated. The proposal also would amend FINRA Rule 0150 to add the FINRA Rule 6700 series to the list of FINRA rules that apply to exempted securities, excluding municipal securities. Finally, FINRA has proposed to amend two provisions in its fee rules to reflect that, initially, FINRA will not charge fees for transactions in U.S. Treasury Securities reported to TRACE. First, Section 1(b)(2) of Schedule A to the FINRA By-Laws would be revised to exclude transactions in U.S. Treasury Securities from the Trading Activity Fee. Second, FINRA Rule 7730(b) would be revised to exclude transactions in U.S. Treasury Securities from the TRACE transaction reporting fees.[42]

E. Effective Date of Proposed Rule Change

FINRA has represented that it will announce the effective date of the proposed rule change and the specific implementation dates in a Regulatory Notice to be published no later than 90 days following Commission approval of the proposal, and that the effective date will be no later than 365 days following Commission approval.[43] FINRA anticipates staggering the implementation dates so that the general reporting requirement is implemented before members are required to include the ".B" and ".S" trade modifiers.[44]

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42 FINRA states that, because it will incur costs to expand the TRACE system and to enhance its examination and surveillance efforts to monitor members' trading activity in U.S. Treasury Securities, FINRA is considering the appropriate long-term funding approach for the program and will analyze potential fee structures once it has more data relating to the size and volume of U.S. Treasury Security reporting. See id. at 48469.

43 See id.

44 See id.

III. Summary of Comments and FINRA's Response

The Commission received 12 comments regarding the proposed rule change.[45] Seven commenters expressed support for the proposal.[46] Several commenters supported the goals of the proposal but argued that regulatory reporting requirements should be expanded to other Treasury market participants that are not FINRA members.[47] Certain of these commenters argued that transaction information provided only by FINRA-member reporting would provide

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45 See supra note 4.

46 See BDA Letter at 1 (stating that regulators should have access to comprehensive Treasury market transaction data); Citadel Letter at 1 (stating that enhanced reporting to the official sector will improve general monitoring and surveillance capabilities, including those designed to detect prohibited trading practices and potential risks to market stability) ; ICI Letter at 1-2 (stating that regulatory reporting of transactions in U.S. Treasury securities could help regulators ensure an efficient and competitive market for all participants, including funds and other investors); KCG Letter at 2- 3 (expressing support for the goal of making U.S. Treasury transactional data more available to regulators); SIFMA Letter at 1-2 (expressing support for the policy goals underlying the proposal and noting that regulatory reporting of U.S. Treasury trades in the secondary market will provide regulators with greater clarity regarding the nature of activity in this market); Tradeweb Letter at 2 (expressing broad support for the policy goals of the proposal and the overall structure of the requirements); Virtu Letter at 2 (stating that access to transaction-level data will help regulators to effectively design surveillance to prevent fraudulent and manipulative acts, and that transaction reporting could inform future decisions regarding standards such as circuit breakers and volatility guards).

47 See Credit Suisse Letter at 3 (requesting that the proposal not be put into effect unless and until the requirements are expanded to non-FINRA-member market participants); Fidelity Letter at 3 (stating that "The official sector and market participants will be best served by coordinated and harmonized reporting requirements across Treasury cash market intermediaries"); SIFMA Letter at 3 (urging the Commission and the Treasury Department to coordinate the implementation of similar requirements for non-FINRA-members); BDA Letter at 1 (urging regulators to work to create a comprehensive reporting regime that would also include banking institutions that do not currently report any fixed-income transactions to TRACE); KCG Letter at 5 (stating that regulators should provide specifics about their plan to collect data from non-FINRA members and should prioritize implementation of this plan); Virtu Letter at 2 (asking the Treasury Department and the Commission to move quickly to capture transactions by non-FINRA members who trade U.S. Treasury securities to help to assure the efficacy of the monitoring system).

regulators with an incomplete view of the U.S. Treasury market.[48] Other commenters noted the disproportionate impact of the proposal on FINRA members and the potential to place FINRA members at a competitive disadvantage vis-à-vis other market participants.[49]

FINRA agreed that the proposal would not capture the entire universe of transactions in the U.S. Treasury market, but stated that the proposal represents a significant and important first step.[50] FINRA also noted that the Treasury Department, the Commission, the Federal Reserve Bank of New York, and the CFTC have stated that they are assessing means to ensure that the collection of data regarding the Treasury market is comprehensive and includes information from institutions that are not FINRA members.[51]

Several commenters discussed the costs associated with the proposal or FINRA's analysis of the costs and benefits associated with the proposal. One commenter disagreed with FINRA's view that the direct costs to FINRA members already reporting to TRACE would be limited, stating that the reporting of transactions in U.S. Treasury securities would require significant IT investment.[52] A second commenter noted that the proposal would be a significant

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48 See Credit Suisse Letter at 3; Fidelity Letter at 4-5 (noting that its concern would be more pronounced if incomplete data were used as a basis for rulemaking); KCG Letter at 5; SIFMA Letter at 3; ICI Letter at 2 (cautioning regulators not to develop rules that would change the structure of the U.S. Treasury market using data obtained through TRACE reporting until regulators attain a more complete view of market activity, including the activity of principal trading firms ("PTFs")).

49 See Credit Suisse Letter at 3; Fidelity Letter at 4; Tradeweb Letter at 2.

50 See FINRA Response at 3.

51 See id. (citing Joint Press Release, Treasury Department et al., Statement Regarding Progress on the Review of the U.S. Treasury Market Structure since the July 2015 Joint Staff Report (August 2, 2016), available at https://www.sec.gov/news/pressrelease/2016-155.html). See also May 16 Joint Press Release, supra note 12.

52 See Credit Suisse Letter at 6. See also Fidelity Letter at 4 (noting the costs associated with the proposal, including technology builds, testing, maintenance of feeds, and the development and maintenance of regulatory compliance programs); Tradeweb Letter at 2

build for firms that do not currently incur TRACE reporting obligations.[53] A third commenter stated that a more thorough implementation discussion prior to approval of the proposal would permit a more robust cost/benefit analysis.[54]

FINRA acknowledged that the proposal would impose certain costs and burdens on FINRA members that would not apply to non-members, but also noted that there are several cost-effective means for members to comply with the new rules.[55] FINRA noted that firms with limited trading volumes generally could use a web browser to report, thereby limiting the cost of reporting.[56] For firms with higher levels of trading activity, FINRA offers direct connectivity via either CTCI or FIX protocols.[57] In addition, FINRA noted that some firms may rely on clearing firms that offer transaction reporting as a service to their correspondents, and that several service bureaus offer TRACE reporting as a service to subscribers to their order management systems.[58] FINRA stated that a majority of its members that are also government securities brokers or dealers currently are registered for, and report to, TRACE.[59] According to FINRA, the FINRA members that are government securities dealers or brokers but currently are not registered for TRACE, or that are registered for TRACE but have not reported a trade between June 2015 and

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(stating that the implementation and phasing of the reporting requirements should be carefully evaluated with respect to the cost and the technical build required).

53 See FIF Letter at 4.

54 See Thomson Reuters Letter at 2.

55 See FINRA Response at 3.

56 See id. at 14-15. FINRA noted that the cost of the secure web browser for reporting purposes is $20 per month. See id. at 14; FINRA Rule 7730(a)(1).

57 See FINRA Response at 14.

58 See id.

59 See id.

May 2016, are predominantly small firms, with 80% having fewer than 25 registered representatives.[60]

Commenters expressed mixed views regarding the proposed timeframes for reporting transactions in U.S. Treasury Securities. Three commenters supported real-time or near-real-time reporting.[61] One commenter supported end-of-day reporting.[62] Two commenters stated that FINRA should provide flexibility to allow firms to report earlier than end-of-day.[63] By contrast, one commenter recommended that transactions in U.S. Treasury securities be reported on a T+1 basis to alleviate reporting challenges presented by the limited hours of the TRACE system.[64]

FINRA responded that, because the reported transaction information would not be publicly disseminated, it is preferable to provide firms with the flexibility to report as appropriate for their current operations (e.g., on a trade-by-trade basis or at the end of the day), rather than to mandate prompt reporting at this time.[65] FINRA noted that this flexibility could ease the compliance burden on some firms, and confirmed that firms that wish to report on an immediate basis could do so.[66] FINRA acknowledged that this reporting timeframe could change in the

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60 See id.

61 See Citadel Letter at 4 (suggesting that FINRA modify the proposal to require reporting within a certain number of minutes or hours following execution); KCG Letter at 4 (recommending real-time reporting); Virtu Letter at 2 (stating that, for surveillance to be effective, the underlying data collection should be comprehensive and immediate, with limited exceptions).

62 See Tradeweb Letter at 2.

63 See FIF Letter at 2; SIFMA Letter at 9.

64 See Credit Suisse Letter at 6.

65 See FINRA Response at 7.

66 See id.

future, and noted that firms may wish to consider this possibility in designing their systems.[67] FINRA disagreed with one commenter's assertion that end-of-day reporting would negatively affect the surveillance of trading in U.S. Treasury Securities.[68]

Several commenters requested clarifications regarding the scope of securities covered by the proposal. One commenter asked FINRA to clarify whether Treasury Inflation-Protected Securities ("TIPS") would be in scope and, if so, to publish for comment an amendment to the proposal providing details regarding the reporting of these transactions.[69] Two commenters requested guidance with respect to the reporting of reopenings of Treasury securities.[70] One commenter requested clarification with respect to the reporting of When-Issued Transactions, noting that execution venues differ in the way that they define and process these transactions.[71]

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67 See id.

68 See id.

69 See Thomson Reuter Letter at 2 (stating that TIPS have characteristics different from other Treasury securities). See also FIF Letter at 2 (stating its assumption that TIPS would be handled in a manner similar to the reporting of securitized products and expressing a preference "that factor information be required only in cases where anything other than the default settlement date or the current factor has been applied").

70 See Credit Suisse Letter at 4 (asking whether reopened trades should be reported using the same CUSIP number as the regular-way security with a different issue date, and noting that reopenings may not be handled consistently across all systems and venues); FIF Letter at 1 (questioning whether reopenings should be considered an extended settlement date trade or should be reported with a "when-issued" flag).

71 See Credit Suisse Letter at 4. The commenter stated that some execution venues treat transactions as when-issued until the night of the auction, while others treat transactions as when-issued only until the day before the issue date. The commenter further stated that some platforms treat when-issued transactions as two separate products during their life cycle, "so additional consideration will be required for subsequent updates to the trade bookings from the [when-issued] to the new On-the-Run Treasury." See id.

FINRA responded that TIPS would be reportable under the proposal and that FINRA is not providing, or requiring the reporting of, factor information in TIPS transactions at this time.[72] FINRA also stated that any transaction in a U.S. Treasury Security to be sold in an Auction but that occurs prior to the Auction, including a reopening transaction effected prior to the Auction or a transaction on the day of the Auction, would be considered a When-Issued Transaction for purposes of the proposed rules.[73]

One commenter expressed support for the proposal to exempt bona fide repurchase and reverse repurchase transactions in all TRACE-Eligible Securities from TRACE reporting.[74] This commenter also noted its assumption that all applicable TRACE rules would apply to in-scope transactions in U.S. Treasury Securities, unless explicitly exempted.[75] FINRA confirmed that, because U.S. Treasury Securities would be included within the definition of "TRACE-Eligible Securities," any rule applicable to TRACE-Eligible Securities would apply to U.S. Treasury Securities, unless specifically exempted.[76]

Commenters also expressed views or raised questions with respect to the reporting of particular data elements. One commenter requested clarification regarding the treatment of inter-dealer broker fees for principal trading and platform fees that may be applied to client transactions.[77] A second commenter stated that an additional field for ATS MPID would be

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72 See FINRA Response at 4-5.

73 See id. at 5-6.

74 See SIFMA Letter at 5-6.

75 See id. at 6.

76 See FINRA Response at 5.

77 See Credit Suisse Letter at 5.

required, and expressed a preference to keep the fields aligned with existing requirements.[78] This commenter also assumed that the "no remuneration" flag would be considered a modifier to be consistent with the reporting of other modifiers under FINRA Rule 6730.[79]

FINRA stated that it would be appropriate to remain consistent with well-established TRACE protocols for reporting commissions, mark-ups, and mark-downs.[80] In addition, FINRA confirmed that both the "no remuneration" flag and the ATS MPID field (to be used when an ATS has received a trade reporting exemption pursuant to FINRA Rule 6732) would be required, as applicable, for reportable transactions in U.S. Treasury Securities.[81] FINRA noted that it has issued rules and provided guidance with respect to remuneration reporting since the implementation of TRACE in 2002, and that its current remuneration guidance will be helpful for reporting of transactions in U.S. Treasury Securities.[82] FINRA added that it will continue to provide timely guidance as needed.[83]

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78 See FIF Letter at 2. Another commenter expressed support for the requirement to report information concerning the ATS on which a transaction is executed. See SIFMA Letter at 6.

79 See FIF Letter at 2.

80 See FINRA Response at 12.

81 See id. at 11.

82 See id. at 11. FINRA noted, for example, that inter-dealer brokers that charge remuneration on a per-transaction basis generally are required to calculate and include such remuneration when reporting the transaction to TRACE. See id. However, commissions, mark-ups, or mark-downs charged on a monthly or other basis that cannot be assessed on a per-transaction basis are not required to be reported. See id. (citing Regulatory Notice 15-47 (November 2015)). In addition, FINRA stated that firms generally should not include platform fees in TRACE reports and should report only bona fide commissions in the commission field. See id. (citing letter from Sharon K. Zackula, FINRA, to Mustafa Fazel, National Financial Services, LLC, dated July 11, 2003, available at http://www.finra.org/industry/interpretive-letters/july-11-2003-1200am).

83 See FINRA Response at 11.

Commenters expressed mixed views regarding the proposed ".B" and ".S" trade modifiers. One commenter supported the use of both modifiers, stating that "it is important that the various types of package transactions involving a U.S. Treasury are able to be accurately identified so that linkages between different types of instruments are better understood."[84] Other commenters expressed concerns regarding these modifiers. One commenter stated that adding the ".B" and ".S" modifiers would be "exceedingly difficult" because firms would have to establish linkages across trading platforms and systems that do not exist today and questioned whether there was a more straightforward way to achieve FINRA's objectives in requiring the use of the modifiers.[85] Commenters suggested that it might be difficult for FINRA members to identify separate trades as components of a series of transactions.[86] One commenter asked FINRA to clarify that the ".B" modifier is intended to capture transactions where both the cash leg and the futures contract relate to U.S. Treasury transactions.[87] The commenter also asked FINRA to provide specific examples of any additional trading strategy that the ".B" modifier is designed to capture, and to provide "a clear and comprehensive list" of each specific type of

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84 Citadel Letter at 2. The commenter also stated that (1) reported data should more generally identify whether a U.S. Treasury security transaction is part of a package and, if so, the number of legs associated with the package and the types of instruments involved (e.g., a future or an interest rate swap); (2) the requirement to report trading venue (if any) should be expanded to include dealer-to-dealer and dealer-to-customer trading venues that currently are exempt from registration as ATSs because they trade only U.S. Treasury securities; and (3) market participants should be required to report whether a transaction was cleared. See id.

85 See FIF Letter at 2. See also SIFMA Letter at 8 (asking regulators to engage in further discussion with the industry prior to adopting the proposed modifiers); Thomson Reuters Letter at 2 (urging FINRA to work with the industry to determine whether the new modifiers are justified).

86 See Credit Suisse Letter at 5; FIF Letter at 2 (stating that adding the ".B" and ".S" modifiers assumes that firms are able to associate multiple trades that may have been executed at different times on different desks and processed independently).

87 See SIFMA Letter at 6.

transaction and strategy to which the ".S" modifier must be applied.[88] Noting that the language of the proposed rule suggested that only transactions executed away from the market should be assigned the ".S" modifier, the commenter recommended instead that the ".S" modifier apply to the specified strategy regardless of whether one or both legs of the trade were off market.[89]

In response to these comments, FINRA reiterated that the ".B" and ".S" modifiers would allow FINRA to more easily identify transactions that, standing alone, might appear to raise regulatory concerns because they were executed at a price that was significantly outside of the price range for the security at the time of execution.[90] FINRA asserted that the modifiers are necessary for effective and efficient implementation of the proposal even if they could result in additional implementation burdens or costs to firms.[91] FINRA stated that ".B" trades are well-defined, in that they relate specifically to a series of trades involving both a U.S. Treasury Security and a futures contract.[92] FINRA agreed that the ".S" modifier should apply to a transaction in a particular strategy that meets the ".S" criteria regardless of whether one or more of the transactions in the series is off market.[93] Accordingly, FINRA filed Amendment No. 1 to the proposal to clarify that the ".S" modifier must be used in these circumstances.[94] FINRA expressed the view that Amendment No. 1 should reduce the compliance burden for firms

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88 Id. at 6, 8.

89 See id. at 7.

90 See FINRA Response at 8-9.

91 See FINRA Response at 9. FINRA also stated that it would monitor the information that it receives after reporting begins to determine whether additional transaction information might be needed to enhance the audit trail and FINRA's surveillance program. See id. at 8; Notice, 81 FR at 48474.

92 See FINRA Response at 9.

93 See id.

94 See supra note 40.

because they would not need to assess, before appending the ".S" indicator, whether a particular transaction was, in fact, priced outside of the market at the time of execution.[95] In addition, FINRA stated that permitting end-of-day reporting would ease the compliance burden on firms in implementing the modifiers.[96]

FINRA declined to publish a list of specific transactions and strategies that would require the ".S" modifier, stating that such a list could not be comprehensive or account for variations that might be appropriate.[97] FINRA also stated that, following any Commission approval of the proposal, it would work with members to better understand their questions and would post any necessary trade reporting guidance on FINRA's website, as it has done in connection with other new trade reporting implementations.[98]

As discussed above, new Supplementary Material .04 to FINRA Rule 6730 would require members to report the time of an electronically executed transaction in a U.S. Treasury Security in the finest time increment captured in the member's system, but at a minimum in increments of seconds. Three commenters opposed this aspect of the proposal.[99] One commenter stated that one standard for timestamps and clock synchronization should uniformly to ensure a level playing field.[100] A second commenter noted that the requirement could result in mismatched timestamps for transactions involving two FINRA members if each member captures time

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95 See FINRA Response at 9.

96 See id.

97 See id.

98 See id.

99 See Credit Suisse Letter at 5; FIF Letter at 3; SIFMA Letter at 9.

100 See FIF Letter at 3.

differently.[101] Two commenters recommended that FINRA eliminate this aspect of the proposal or, alternatively, that FINRA confirm that it would not require members to update their systems to provide for time increments of less than one second.[102]

FINRA reiterated that a significant portion of trading activity in the U.S. Treasury cash market occurs on electronic platforms that currently capture timestamps in sub-second time increments.[103] FINRA stated that more granular timestamps on execution data could enhance its ability to surveil trading activity and recreate the proper time sequencing of trades.[104] In addition, FINRA noted that it recently required firms that capture time in milliseconds to report time to the millisecond level when reporting trades in equity securities to FINRA.[105] FINRA noted that in adopting this requirement for equity securities, it did not require firms to update their existing systems, but simply required firms to report time at the same level that they captured it.[106] FINRA believed that a similar approach is appropriate for transactions in U.S. Treasury Securities that are executed electronically.[107]

Two commenters recommended that FINRA update its daily list of reportable securities to include CUSIP numbers of U.S. Treasury Securities that are TRACE-eligible, so that members would not have to take steps to have such securities placed on the list.[108] FINRA stated that it intends to update the daily list to include the CUSIP numbers of outstanding U.S. Treasury

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101 See Credit Suisse Letter at 5.

102 See SIFMA Letter at 9; Credit Suisse Letter at 5.

103 See FINRA Response at 10.

104 See id. at 10-11.

105 See id.; Regulatory Notice 14-21 (May 2014).

106 See FINRA Response at 10.

107 See id.

108 See FIF Letter at 1; SIFMA Letter at 8.

Securities and thereafter add CUSIP numbers of new securities coincident with the announcement of an auction.[109]

Commenters also discussed general aspects of the reporting process. One commenter expressed hope that FINRA would utilize existing message formats to the extent possible.[110] A second commenter urged FINRA to allow reporting of transactions in U.S. Treasury Securities through an existing line, rather than requiring new network connectivity.[111] This commenter also asked FINRA to work directly with the FIX protocol organization to create industry standard tags for use in reporting new indicators and modifiers.[112]

FINRA stated that TRACE generally allows a firm reporting through FIX or CTCI to use the same connection line to submit transactions to the system.[113] FINRA noted that some firms currently use the same connection line to report transactions in the TRACE products that are currently available.[114] FINRA stated that firms using the FIX protocol to report transactions may use the same connection line but are required to obtain separate ports for each product, and that a firm's need to obtain and operate separate lines is dependent on the firm's activity in each product and its desired balance between costs and latency/performance.[115]

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109 See FINRA Response at 12.

110 See FIF Letter at 2.

111 See Thomson Reuters Letter at 2.

112 See id. at 1.

113 See FINRA Response at 13.

114 See id.

115 See id.

Commenters also asked FINRA to confirm that error corrections submitted intra-day would not count toward a firm's error statistics,[116] and that there would be no fees or charges for intra-day corrections.[117] FINRA stated that, as in other FINRA trade reporting contexts, re-reporting or amending transaction reports would be captured in a firm's error statistics published on the TRACE Report Cards even if the transactions are not considered late.[118] Because FINRA is not at this time proposing to charge fees for reporting transactions in U.S. Treasury Securities, there also would be no fees charged for re-reports or amendments.[119]

Commenters expressed mixed views regarding the proposal's assignment of reporting obligations. One commenter urged FINRA to re-assess the dual-sided reporting obligation, stating that the transaction volume in the U.S. Treasury market may warrant a different approach to reduce complexity and data discrepancies, and arguing that a single-sided reporting hierarchy could reduce implementation costs by leveraging trading venues and registered broker-dealers.[120] Other commenters expressed support for use of the existing framework for TRACE reporting.[121]

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116 See FIF Letter at 2; SIFMA Letter at 9.

117 See FIF Letter at 2.

118 See FINRA Response at 12.

119 See id.

120 See Citadel Letter at 3. The commenter also stated that a single-sided methodology could be more easily applied to other market participants as reporting requirements are extended to include trading activity involving non-FINRA members. See id.

121 See ICI Letter at 2 (stating that the proposal would leverage the existing reporting and communications systems for TRACE reporting rather than imposing obligations on customers—such as funds and other investors—that do not currently have systems to accommodate such obligations); SIFMA Letter at 2 (stating that the proposal leverages the existing framework of the TRACE system and that FINRA members generally have systems and procedures in place that can incorporate the additional reporting obligations for U.S. Treasury securities). One commenter also noted that, because virtually all trades in U.S. Treasury securities involve an intermediary—such as a broker-dealer, trading platform, or PTF—regulators would be able to obtain comprehensive information about

FINRA stated that it continues to believe that a two-sided reporting requirement, like that which currently applies to all TRACE transactions, is also appropriate for transactions in U.S. Treasury Securities.[122] FINRA expressed the view that two-sided reporting helps to ensure accuracy because it allows FINRA to compare information reported by each party to identify discrepancies or potential non-reporting by one party, thereby enhancing the quality of the audit trail.[123] FINRA stated, moreover, that altering TRACE requirements to accommodate single-sided reporting would necessitate changes to TRACE's existing infrastructure that could affect all TRACE-reporting firms and reduce the benefits of using TRACE for U.S. Treasury Security reporting.[124]

Three commenters expressed support for the proposed one-year implementation period, noting, among other things, the complexity of the system modifications that would be required to comply with the proposed rules.[125] Two commenters supported the proposed staggered

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the U.S. Treasury market by receiving trade reports from intermediaries. See ICI Letter at 2.

122 See FINRA Response at 6.

123 See id.

124 See id.

125 See Credit Suisse Letter at 6 (noting that U.S. Treasury securities are traded within the firm across multiple divisions and on various trading platforms, none of which capture trade information in a uniform or consistent manner); FIF Letter at 3-4 (noting that broker-dealers must devote resources to comply with multiple regulatory initiatives); SIFMA Letter at 10 (noting that reportable U.S. Treasury market activity may occur throughout a firm and on different desks, and that a one-year implementation period would allow for the integration of these activities within a firm's reporting apparatus). See also Tradeweb Letter at 3 (expressing the need for "an appropriately sized implementation period" to allow firms to develop, test, and implement the necessary technical changes and internal policies and procedures); Thomson Reuters Letter at 3 (stating that the implementation effort will be complex and require significant coordination across the industry). One commenter noted that firms that are solely government securities dealers, which previously have not reported to TRACE, would be required to develop reporting systems and policies from scratch. See SIFMA Letter at

implementation period for the ".B" and ".S" modifiers,[126] with one commenter noting that implementing the modifiers would require extended development time.[127] Three commenters emphasized the importance of FINRA's publishing technical specifications as far in advance as possible.[128] One of these commenters asked FINRA to release a technical specification with expected changes for all phases of implementation to avoid multiple code releases.[129]

FINRA acknowledged the importance of timely and detailed technical specifications to ensure that firms are able to effectively implement the new reporting requirements, and stated that it is preparing to publish technical specifications concurrent with any Commission approval of the proposal.[130] FINRA also acknowledged the implementation challenges that firms might face if the proposal is approved, and stated that it would consider these challenges in establishing an implementation date.[131]

Commenters expressed different views of FINRA's determination not to impose fees at this time for reporting transactions in U.S. Treasury Securities. One commenter expressed support for this aspect of the proposal.[132] A second commenter expressed concern that trade reporting fees eventually will be charged and could be significant.[133] A third commenter stated

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10. Another commenter stated that certain required data elements, including counterparty identifiers and the total dollar amount of commissions, would require additional implementation efforts. See Credit Suisse Letter at 5.

126 See FIF Letter at 2; SIFMA Letter at 10-11.

127 See SIFMA Letter at 11.

128 See id. at 10; Thomson Reuters Letter at 1; Tradeweb Letter at 3.

129 See Thomson Reuters Letter at 2.

130 See FINRA Response at 14.

131 See id.

132 See BDA Letter at 2.

133 See Fidelity Letter at 4.

that the proposal's ambiguity regarding the charging of fees makes it difficult to understand the true cost of the proposal and expressed the view that FINRA should not assess fees with respect to the reporting of transactions in U.S. Treasury Securities for a minimum of five years.[134]

FINRA stated that, because it would incur costs to expand the TRACE system and to enhance its existing examination and surveillance efforts to monitor transactions in U.S. Treasury Securities following any Commission approval of the proposal, it was unable to commit to continuing to exclude these transactions from the applicable fees for a specified period.[135] FINRA noted, however, that any new fees would be subject to a proposed rule change filed with the Commission.[136]

Several commenters expressed support for, or raised concerns regarding, the public dissemination of information with respect to transactions in U.S. Treasury Securities.[137] FINRA reiterated that it is not proposing to disseminate information with respect to transactions in U.S.

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134 See Thomson Reuters Letter at 2.

135 See FINRA Response at 13.

136 See id.

137 See Carson Letter (expressing support for transparency in the U.S. Treasury market); Citadel Letter at 3-4, 6 (recommending that FINRA ensure that the reporting infrastructure is scalable and able to accommodate possible public dissemination of transactions in U.S. Treasury securities in the future); KCG Letter at 4 (supporting real-time reporting and immediate public dissemination); BDA Letter at 1 (urging financial regulators to refrain from moving forward with any proposal to require public dissemination); Credit Suisse Letter at 7 (recommending that regulators study the potential risks of public dissemination and consult with the industry before moving forward); Fidelity Letter at 5 (urging careful consideration of any decision regarding public dissemination); ICI Letter at 3 (stating that the appropriateness of public dissemination should be considered after the official sector has obtained a more complete view of Treasury market activity); SIFMA Letter at 5 (urging careful consideration of costs and benefits of public dissemination) and 11 (asking regulators to defer any analysis of pricing data in connection with potential public dissemination until the ".B" and ".S" trade modifiers are included in reported data); Tradeweb Letter at 3 (urging regulators to weigh carefully the potential benefits and risks of public dissemination).

Treasury Securities at this time, and stated that careful consideration of the potential benefits of public dissemination, as well as the concerns raised by the commenters, should be undertaken after a reporting requirement is in place.[138]

IV. Discussion and Commission Findings

After carefully considering the proposal, the comments submitted, FINRA's response to the comments, and Amendment No. 1, the Commission finds that the proposed rule change, as modified by Amendment No.1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities association.[139] In particular, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Act,[140] which requires, among other things, that FINRA's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

Prior to TRACE's implementation, the National Association of Securities Dealers ("NASD") (FINRA's predecessor) did not have routine access to comprehensive transaction information for the over-the-counter corporate bond market, even though the NASD bore responsibility for regulating that market. In originally approving the TRACE rules, the Commission stated that obtaining such information to better conduct market surveillance was a fundamental means of promoting fairness and confidence in U.S. capital markets.[141] Similarly, with respect to the over-the-counter market for U.S. Treasury Securities, FINRA, the

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138 See FINRA Response at 4.

139 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

140 15 U.S.C. 78o-3(b)(6).

141 See Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131, 8136 (January 29, 2001) (order approving File No. SR-NASD-99-65).

Commission, and other public authorities currently do not possess information to properly oversee the market. The Commission believes, therefore, that it is consistent with the Act for FINRA to expand TRACE to designate U.S. Treasury Securities as TRACE-Eligible Securities and to establish reporting requirements relating to such securities in the manner set forth in the proposal.[142] Expanding TRACE to include member transactions in U.S. Treasury Securities is reasonably designed to help FINRA fulfill its mandate in Section 15A(b)(6) of the Act to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

The Commission believes that FINRA's proposal is an important first step in providing the official sector with more comprehensive data about the Treasury cash market. The RFI Notice stated that "[t]he need for more comprehensive official sector access to data, particularly with respect to U.S. Treasury cash market activity, is clear"[143] and that "[d]ata from across the U.S. Treasury cash and futures markets is necessary to conduct comprehensive analysis or surveillance of these markets."[144] The Commission believes that FINRA's proposal is reasonably designed to further these objectives outlined in the RFI Notice with respect to the Treasury cash market. The transaction data that will become available to the official sector through TRACE will help to inform policymaking and help regulators detect and deter improper trading activity.

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142 The Commission notes that FINRA previously has expanded TRACE to require the reporting to TRACE of transactions in agency debt securities and asset-backed securities. See Securities Exchange Act Release Nos. 61566 (February 22, 2010), 75 FR 9262 (March 1, 2010) (order approving File No. SR-FINRA-2009-065) ("Asset-Backed Securities Order"); and 60726 (September 28, 2009), 74 FR 50991 (October 2, 2009) (order approving File No. SR-FINRA-2009-010).

143 81 FR at 3931.

144 Id. at 3932.

The Commission acknowledges the concerns raised by various commenters that the proposal could create a competitive advantage for non-FINRA members over FINRA members, because only FINRA members will incur costs for reporting transactions in U.S. Treasury Securities and because counterparties might seek to avoid trading with FINRA members to shield their trading activity from regulatory oversight. Commenters also noted that imposing a reporting requirement solely on FINRA members would provide regulators with a less-than-comprehensive view of activity in the Treasury market. The Commission believes, nevertheless, that these comments do not preclude approval of the proposal at this time. The Commission recognizes that certain transactions in the Treasury market will not be within scope of the new TRACE reporting requirements, but the transactions that are reported should greatly enhance regulators' understanding of the market. The Commission notes that other public sector authorities have expressed their intention to continue to assess effective means to ensure that the collection of data regarding Treasury cash securities market transactions is comprehensive and includes information from institutions that are not FINRA members.[145]

Furthermore, the Commission believes that the proposal is reasonably designed to minimize any potential disparate impact on FINRA members. FINRA is not proposing at this time to publicly disseminate any transactions in U.S. Treasury Securities.[146] In addition, FINRA is not at this time imposing any fees on its members for reporting transactions in U.S. Treasury Securities, so FINRA members will not face any additional direct costs that their competitors do

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145 See http://www.sec.gov/news/pressrelease/2016-155.html; May 16 Joint Press Release, supra note 12.

146 Pursuant to Section 19(b)(5) of the Act, 15 U.S.C. 78s(b)(5), the Commission shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by FINRA that primarily concerns conduct related to transactions in government securities, including any proposed rule that would provide for public dissemination of transactions in U.S. Treasury Securities.

not. The Commission recognizes that FINRA members could face additional indirect costs to expand their infrastructure, policies, and procedures that support TRACE reporting. However, the proposal is reasonably designed to minimize those costs. Many FINRA members that will be subject to the new reporting requirements for U.S. Treasury Securities already report transactions in other types of debt securities to TRACE, so their costs of complying with this proposal are likely to be incremental rather than wholesale. FINRA members who are active in the Treasury market are likely to be active in other fixed income markets, and are thus likely to be familiar with existing protocols for reporting transactions to TRACE. To the extent that certain firms become subject to TRACE reporting requirements for the first time (or firms that already carry out TRACE reporting from certain desks have other desks that do not currently trade TRACE-Eligible Securities and do not yet have TRACE capabilities), FINRA's proposal to allow transactions to be reported by end-of-day should provide such firms with some flexibility to determine the most cost-effective way of meeting the new reporting requirements, while allowing regulators to obtain Treasury market transaction information in a reasonable timeframe.

The Commission believes that the timeframes proposed by FINRA for reporting a transaction in a U.S. Treasury Security—on an end-of-day or next-day basis, depending on the time that the transaction was executed—are consistent with the Act. The Commission previously has approved a similar approach of allowing extended reporting timeframes when new asset classes were made TRACE-eligible and FINRA sought to make accommodations for the new compliance burdens.[147]

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[147] See Asset-Backed Securities Order, supra note 142, at 9264-65 (implementing a T+1 reporting period for a six-month pilot period to ease the compliance burdens on those affected by the proposal).

The proposal generally extends existing TRACE reporting protocols, which the Commission has approved previously, to transactions in U.S. Treasury Securities. For example, the proposal retains FINRA's existing dual-sided reporting structure (where both parties are FINRA members),[148] which has been utilized since TRACE's inception. The Commission believes that dual-sided reporting for transactions in U.S. Treasury Securities is consistent with the Act because having both sides report (where both parties are FINRA members) is reasonably designed to promote the accuracy of reported transaction information and, thus, the quality of the audit trail. As a general matter, the Commission believes that utilizing the existing TRACE reporting framework to the extent practicable should facilitate compliance and minimize the costs associated with the proposal. Members that currently report to TRACE generally will be able to leverage their existing reporting processes, with some modifications, to report transactions in U.S. Treasury Securities.

FINRA proposed various changes to existing TRACE rules and definitions that will define the scope of U.S. Treasury securities and transactions that will become subject to the TRACE reporting requirements. For example, the proposal excludes transactions in savings bonds because such bonds are generally non-transferable and are therefore not marketable securities purchased and sold in the secondary market. Although trading a principal or interest component of a U.S. Treasury Security that has been separated under the STRIPS program would constitute a Reportable TRACE Transaction, the act of separating or reconstituting the components of a U.S. Treasury Security under the STRIPS program would not constitute a Reportable TRACE Transaction. This is because, for purposes of the trade reporting rules, FINRA considers a "trade" or a "transaction" to entail a change of beneficial ownership between

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148 See FINRA Rule 6730(a).

parties.[149] The Commission notes that this is consistent with FINRA's existing treatment of transactions that do not involve a change of beneficial ownership.[150] For Treasury auctions, the Treasury Department maintains the auction data, which is available to regulators.[151]

Furthermore, the proposal excludes from reporting bona fide repurchase and reverse repurchase transactions involving TRACE-Eligible Securities. Historically, FINRA has taken the position that repurchase transactions and reverse repurchase transactions should not be reported to TRACE.[152] According to FINRA, the transfer of securities effectuated as part of a repurchase or a reverse repurchase transaction is not the result of an investment decision but is more akin to collateral pledged as part of a secured financing.[153] Therefore, FINRA views repurchase and reverse repurchase transactions as economically equivalent to financings, and the pricing components of such transactions are typically not the market value of the securities.[154] The Commission believes that FINRA's proposed rules for defining the scope of U.S. Treasury securities and transactions that will become subject to the TRACE reporting requirements are consistent with the Act. If FINRA seeks to revise the scope of covered securities or transactions in the future, it would have to do so consistent with the requirements of the Act and, in particular, the rule filing requirements of Section 19(b) of the Act.

The Commission believes that it is consistent with the Act for FINRA to adopt certain new rules and to revise certain existing rules to accommodate particular features of U.S.

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149 See supra footnote 13.

150 See id.

151 See Notice, 81 FR at 48467.

152 See id.

153 See id.

154 See id.

Treasury securities or the Treasury market. The Commission believes, for example, that the new trade indicator required for When-Issued Transactions is reasonably designed to promote the accuracy of the audit trail and allow FINRA to better understand the price of a reported transaction. The Commission believes that the new ".B" and ".S" modifiers are reasonably designed to provide regulators with a more complete understanding of activity in the Treasury market by identifying transactions that are negotiated as part of a larger strategy.[155] The Commission notes that FINRA has represented that it will work with members on implementing the new modifiers and will post any necessary guidance on its website.[156]

The proposal adds new FINRA Rule 6730, Supplementary Material .04, to require a member to report an electronically executed transaction in a U.S. Treasury Security to the finest increment of time captured in the member's system, but at a minimum in increments of seconds. The Commission notes that this requirement is consistent with existing FINRA rules that require a member to report a trade in an equity security in milliseconds if the member's system captures time in milliseconds.[157] The Commission agrees with FINRA that capturing the time of execution in more granular increments, when available, could assist FINRA in sequencing trades and enhance its ability to surveil trading activity.[158]

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155 The Commission notes that Amendment No. 1 addresses the concerns of one commenter by revising the ".S" modifier to indicate that the modifier will apply to a strategy that meets the ".S" criteria regardless of whether one or more of the transactions in the series is, in fact, off market. See Amendment No. 1; FINRA Response at 9.

156 See FINRA Response at 9.

157 See FINRA Rules 6380A, Supplementary Material .04; 6380B, Supplementary Material .04; 6622, Supplementary Material .04; and 7440(a)(2). See also FINRA Regulatory Notice 14-21 (May 2014).

158 See FINRA Response at 10-11.

FINRA stated that the effective date for the proposal shall be no later than 365 days following this approval, with the general reporting requirement preceding the requirement to use the ".B" and ".S" trade modifiers.[159] As noted above, several commenters supported a one-year implementation period.[160] The Commission believes that the proposed timeframe for implementation is consistent with the Act, and that the commenters have not raised any issue that would preclude approval of the proposal at this time. The Commission notes that FINRA has acknowledged the importance of timely publication of the technical specifications for reporting, and indicated that it would publish technical specifications concurrent with this approval.[161]

The proposal amends existing FINRA Rule 6750(b) to add U.S. Treasury Securities to the list of transaction types for which transaction information will not be disseminated. The Commission believes that it is consistent with the Act for FINRA to refrain from publicly disseminating information regarding transactions in U.S. Treasury Securities at this time. The Commission agrees that it is appropriate to study the transaction information that will be reported to regulators under this rule change before proceeding with any new proposal to provide for the public dissemination of information concerning transactions in U.S. Treasury Securities. The proposal also amends FINRA's existing rules to provide that, at this time, FINRA will not charge fees for transactions in U.S. Treasury Securities reported to TRACE. The Commission believes that it is within FINRA's discretion to refrain from charging fees for reporting transactions in

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159 See Notice, 81 FR at 48469. FINRA also represented that it will announce the effective date of this proposed rule change in a Regulatory Notice to be published no later than 90 days following this approval. See id.

160 See supra note 125 and accompanying text.

161 See FINRA Response at 14. See also Notice, 81 FR at 48469 (FINRA's acknowledgement that sufficient lead-time between the publication of technical specifications and the implementation date is critical to firms' ability to meet the announced implementation date).

U.S. Treasury Securities at this time. The Commission notes that FINRA would be required to file with the Commission, pursuant to Section 19(b)(1) of the Act, any proposal to establish transaction reporting fees for, or to provide for the public dissemination of, transactions in U.S. Treasury Securities.

Pursuant to Section 19(b)(5) of the Act,[162] the Commission consulted with and considered the views of the Treasury Department in determining to approve the proposed rule change. The Treasury Department supports FINRA's proposal to require its members to report transactions in U.S. Treasury Securities to TRACE.[163] Pursuant to Section 19(b)(6) of the Act,[164] the Commission has considered the sufficiency and appropriateness of existing laws and rules applicable to government securities brokers, government securities dealers, and their associated persons in approving the proposal. As noted above, regulators currently do not have ready access to information about transactions in the U.S. Treasury cash market, and the events of October 15, 2014, highlighted the importance of making available to regulators more comprehensive information concerning activity in this market.[165] By requiring FINRA members, including those that are government securities brokers or dealers, to report transactions in U.S. Treasury Securities to TRACE, the new rules represent an important first step in providing

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162 15 U.S.C. 78s(b)(5) (providing that the Commission "shall consult with and consider the views of the Secretary of the Treasury prior to approving a proposed rule filed by a registered securities association that primarily concerns conduct related to transactions in government securities, except where the Commission determines that an emergency exists requiring expeditious or summary action and publishes its reasons therefor").

163 Telephone conversation between Treasury Department staff and Stephen Luparello, Director, Division of Trading and Markets, et al., Commission, on October 14, 2016.

164 15 U.S.C. 78s(b)(6).

165 See RFI Notice, 81 FR at 3931.

regulators with more comprehensive information concerning activity in the U.S. Treasury cash market.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FINRA-2016-027 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2016-027. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F

Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2016-027 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,[166] for approving the proposed rule change, as modified by Amendment No. 1, prior to the 30th day after the publication of Amendment No. 1 in the Federal Register. The Commission believes that Amendment No. 1 addresses the commenter's suggestion that the ".S" modifier apply to transactions in a series that meet the ".S" criteria regardless of whether one or more of the transactions is executed away from the market.[167] The Commission believes that the changes with respect to the ".S" modifier simplify the rule, and ease the compliance burden associated with it, by eliminating the need for members to determine whether a transaction was priced outside of the market at the time of execution. At the same time, the ".S" modifier will facilitate oversight and provide regulators with information and insights into trading activity by identifying transactions in U.S. Treasury Securities that were executed as part of a series of transactions. Accordingly, the Commission finds that good cause exists to approve the proposal, as modified by Amendment No. 1, on an accelerated basis.

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166 15 U.S.C. 78s(b)(2).

167 See SIFMA Letter at 7.

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[168] that the proposed rule change (SR-FINRA-2016-027), as modified by Amendment No. 1, is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[169]

Brent J. Fields
Secretary

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[168] 15 U.S.C. 78s(b)(2).

[169] 17 CFR 200.30-3(a)(12).

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